

Financing Mechanisms Available Under Current Law

Transportation Infrastructure Financing Alternatives Committee

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This paper provides background on those financing mechanisms available to state government under current law for funding major transportation infrastructure projects. Available funding mechanisms fall into four general categories:

- Tax-backed Bonds;
- Revenue Bonds;
- Certificates of Participation; and
- Private financing, or a combination of public and private financing.

I. Tax-Backed Bonds

For purposes of transportation financing, the discussion of government bonds will focus on bonds supported by the motor vehicle fuel tax (gas tax). Gas tax bonds in Washington are often referred to as “double-barreled bonds”. So-called because they have two sources of tax backing. The bonds are primarily backed by state gas tax revenues. Should gas tax revenues prove to be inadequate, the bonds are also backed by the full faith and credit of the state. This means that the bondholders could look to the general fund for satisfaction of the bond debt.

Article VIII, section 1(i) of the Washington State Constitution requires a 60% majority vote in each house of the Legislature to authorize bond issuance. Once the indebtedness has been authorized, the state Finance Committee determines the terms and conditions of the sale. A sale cannot go forward without the approval of the Finance Committee.

Gas tax bonds are not subject to the constitutional or statutory debt limit, *See* Washington State Constitution Art. VIII, §1(g). As the debt to revenue ratio increases, however, consideration of the amount of gas tax revenue tied up in debt service could negatively impact interest rates. Currently between 30 and 35% of the state gas tax revenues¹ are pledged for bonds. Not all of those bonds have been issued.

Tax-backed bonds fall into two general categories: serial bonds and capital appreciation bonds.

¹“State gas tax revenues” here refers to the remainder of gas tax collections remaining to the state after statutory distributions and refunds.

Serial bonds are the most common instrument. These are usually sold for a 25 year term with principal and interest payments made throughout the term. Capital appreciation or “zero coupon” bonds are sold for varying terms and do not require periodic payments. Instead, the principal and interest are payable in full at the maturation date. In the absence of a gas tax appropriation, zero coupon bonds are used to cover the debt service on a toll project for the period between when construction begins and when tolls can first be charged.

Another tax- backed bond mechanism available is the “garvee” bond. A garvee bond borrows against federal fuel tax revenues. The federal government appropriates federal gas tax revenues to the states six years at a time. A free-standing or “naked” garvee bond can be very expensive because of the lack of a concrete pledge of federal gas tax dollars more than six years out. This state has not opted to issue garvee bonds.

II. Revenue Bonds

Revenue bonds are payable solely from revenue from a specific source or pooled revenue from various sources. Revenue bonds may be project based, i.e. the Hood Canal floating bridge, or tax based, such as project oriented taxes levied to finance a convention center. Revenue bonds are not backed by the gas tax or the full faith and credit of the state.

RCW 47.60.060, first enacted in 1949, authorizes the department of transportation to issue revenue bonds for ferries or toll bridges. The bonds are not general obligations of the state and are payable only from revenues of the project financed. The state used this mechanism for funding toll bridges in the past, such as the Hood Canal toll bridge. When the department of Transportation was formed in the 1970's, revenue bond debt was reissued as full faith and credit debt. Since that time no State transportation projects have been financed solely with revenue bonds.

The Tacoma Narrows Bridge project incorporates tolls, but the bonds are not revenue bonds. The bonds are backed by the gas tax and the full faith and credit of the state. From a budget perspective, the bonds will be paid off from toll proceeds. From an investor's perspective, that is irrelevant. The bonds ultimately rest on the full faith and credit of the state. For this reason the Tacoma Narrows Bridge bonds have been sold at tax-backed bonds interest rates rather than revenue bond interest rates.

III. Certificates of Participation

Certificates of participation (COPs) can also be used for some capital projects. Under a COP, the holders of the COPs are represented by a trustee who holds an underlying ground lease on the property. At the end of the lease term the state takes ownership of the asset, usually for a nominal fee. A recent example is the Department of Ecology building constructed in Lacey. In entering into the agreement, the state is making a pledge of future appropriations, which is distinct from a pledge of revenues. If the state defaults, i.e. refuses to appropriate sufficient funds to cover the lease payment, the trustee can operate the facility. Unlike bond holders, the trustee does not have the right to sue the state to compel payment.

Theoretically, a COP could be used to finance a toll road or bridge. The COPs would be backed solely by revenue from the facility. The trustee would have the right to operate the facility in the event of default. Obviously the prospect of a private entity taking over and operating a portion of the public highway system raises legal and policy issues about the viability or advisability of such a scheme.

IV. Private Financing

Under current law, public financing is only authorized for projects built under the Public Private Initiatives in Transportation act (PPI). Chapter 47.46 RCW authorized full or partial private financing for transportation projects built under the PPI law. No additional projects may be built under the PPI law unless that law is amended.

Some issues to consider when contemplating private financing:

- Private bonds do not constitute public debt and thus do not encumber state revenues.
- Private bonds are, generally, more expensive than public debt. It is difficult to beat the full faith and credit of the state as a guarantee of payment.
- Private bonds often entail additional financing costs, including:
 - Coverage factor: tolls set high enough to provide to ensure that debt service payments can be met even if traffic falls short on projections;
 - Contingency reserves: bondholders often require establishing contingency reserves to meet unexpected costs arising during construction. Establishing contingency reserves requires selling additional bonds at the start of the project to establish the reserves.